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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Allocation of Costs Associated with	)	CC Docket No. 96-112
Local Exchange Carrier Provision of	)	
Video Programming Services	)	

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To the Commission:

Comments

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Summary

This is an unnecessary docket. It may however, have serious public policy implications. It is the cable industry's last chance to use federal regulation to defeat LEC entry into the wireline distribution of multichannel video programming. The cable industry has been beating the cost allocation drum ever since it became obvious that LECs would be permitted to compete with incumbent cable operators. The cable industry's goals in this docket are easily predicted (1) achieve extremely high allocations of joint and common costs to cable services; (2) require LECs to price cable service to cover those allocations in addition to direct costs; and (3) require LECs to reduce rates for existing telephone services by the amount of those allocations. If the cable industry is successful it will have no reason to fear wireline competition from LECs These results would simultaneously price LECs' cable service out of the market and create substantial penalties for entering the cable business. Unless the Commission refuses to serve the interests of incumbent cable operators in this proceeding, it risks completely undermining Congress' intent to encourage LEC entry into the video programming business

The Commission's price cap regulation eliminates any need for cost allocation requirements and thus for a proceeding to impose additional cost allocation requirements. Price cap regulation has severed the direct link between LECs' accounting costs and their rates. It has thereby removed any incentive or ability to cross-subsidize nonregulated services with revenues from regulated services. The Commission has recognized this effect of price cap regulation in its rate regulation of

cable operators. It has imposed no cost allocation or affiliate transaction rules on price cap cable operators. It has not even imposed a uniform system of accounts on cable operators. The Commission can give this docket purpose and can further the public's interest in infrastructure deployment and competitive entry by eliminating cost allocation requirements for price cap LECs as well.

This bold action would signal the markets that the Commission is serious about promoting infrastructure development and competitive entry. It would send a clear message that the Commission will no longer tolerate efforts to handicap LECs' entry into competitive markets. This bold action would not, however, be risky. Price caps already eliminates any perceptible risk that telephone customers will bear the costs or risks of competitive businesses. Looming competitive entry into local telephone markets puts additional pressure on LECs' pricing of local services. Existing competition in financial markets, moreover, leaves no room for LECs to invest in new businesses that will not increase the value of the firm. Thus, elimination of this vestige of rate-of-return regulation will not create any risk to telephone customers.

Continued reliance on cost allocations is regressive. It looks backward to rate-of-return regulation. It underrates the effectiveness of price cap regulation and the impact of competitive entry in local telecommunications markets. Reliance on regulatory tools of the past will hinder the development of competition, unfairly penalize incumbent LECs for investing to meet the full range of future communications needs, and waste public and private resources. The perpetuation of cost allocation rules disregards the Commission's duty to forbear from applying any unnecessary regulation.

The Commission's desire to find a regulatory mechanism that confers the benefits of economies of scope on telephone customers should not be the controlling objective in this proceeding Such potential benefits are minuscule compared to the benefits that telephone and cable customers will reap from unregulated competition Thus, the Commission's primary consideration should be whether its action will promote infrastructure development and encourage vigorous competition between telephone companies, cable companies, and others The Notice is far too concerned with short-term goals of cost allocations and manifests virtually no faith in the procompetitive forces that Congress has unleashed.

If, notwithstanding the lack of a need for cost allocation rules, the Commission retains or amends its cost allocation rules, it should not treat investment reallocations resulting from such cost allocations as exogenous cost changes. Such reallocations do not meet the tests for exogenous treatment They are not beyond control of LECs, which can choose to invest or not to invest in integrated plant for the provision of regulated and nonregulated services. Economies of scope are reflected in productivity adjustments. Exogenous treatment of reallocations of jointly used would double count productivity gains in price index adjustments Moreover, exogenous treatment of investment reallocations is related to investment on the books at the beginning of LEC price cap regulation, July 1, 1990. Little of the plant that BellSouth may use for the joint provision of cable services and telephone services was on the books on that date. Finally, an exogenous cost adjustment, particularly one based on a substantial, arbitrary allocation could have such adverse financial effects that LECs would be forced either to provide new competitive services on separate networks, thereby foregoing economies of scope, or not to offer the new services at all. Either result would diminish the public welfare.

If the Commission retains and amends its cost allocation rules, its should make them less, not more, arbitrary. It should ensure that those rules are flexible enough to accommodate growing differences among LECs their markets, and their rapidly changing networks. The best means to achieve such flexibility is to leave the details to each LEC's CAM, as the Commission generally does today. The Commission should not mandate fixed allocators or specific formulas. Such rigid mandates would necessarily ignore differences in LECs and the effects of rapidly changing technology. Fixed allocators would not necessarily be easier to administer than other methods.

The rules should not preclude the approach in BellSouth's CAM. BellSouth filed CAM changes on June 30 1995, to accommodate the joint use of central office equipment and outside plant for telephone and cable services (whether provided over a cable system or an open video system). There was no opposition, and the changes became effective September 1, 1995. By allocating investment based on forecasted cable service and telephony subscriber circuit counts, BellSouth's approach complies with Part 64's requirement that such allocations be usage based. Because it allocates joint costs at the study area (state) level, it is easier and more efficient to administer and review than methods, such as fixed allocators, which could require recordkeeping at the exchange level or lower.

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Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services	)))	CC Docket No. 96-112

To the Commission:

Comments

BellSouth Corporation and BellSouth Telecommunications, Inc., hereby submit these comments in response to the Commission's Notice of Proposed Rulemaking released May 10, 1996 (FCC No. 96-214) ("Notice").

I. Introduction

The Notice proposes to amend the Commission's "cost allocation rules and procedures to accommodate an incumbent local exchange carrier's use of the same network facilities to provide video programming service and other competitive offerings not subject to Title II regulation, as well as telephony and other Title II offerings."[1] The Notice seeks comment on "whether and how the procedures established in this proceeding should be applied to incumbent local exchange carrier ["LEC"] provision of video programming services and other competitive offerings by those companies."[2] Unfortunately, the Notice focuses almost exclusively on "how" to impose additional

[1] Notice, ¶ 2.
[2] Notice, ¶ 2.

regulatory burdens on LECs and gives no consideration to "whether" the contemplated regulations are necessary.

II. The Commission Should Clarify The Objectives Of This Proceeding.

Because the Notice fails to deal seriously with whether cost allocation rules are necessary in today's changing environment, it is remarkably vague about the purposes and objectives of this proceeding. Its stated objective is "to establish a system of cost allocation principles that inhibits carriers from imposing on ratepayers the costs and risks of competitive, nonregulated ventures, including nonregulated video service ventures."[3] The Notice ignores, however, the fundamental issue of whether competition will permit anyone other than the LECs' shareholders to bear the risks of LECs' activities.

The Notice also intends to create an entitlement for telephone ratepayers "to at least some of the benefit of the economy of scope between telephony and competitive services."[4] This intent reflects the widely held misconception that telephone networks are built with the money of ratepayers, rather than investors. The misconception leads to a misunderstanding of who bears the risks and costs of LECs' activities.

The Notice states that the "proceeding is not intended to protect competitors in video service or other competitive markets."[5] Nevertheless, it goes on to say that "our rules will intentionally allocate a significant part of common costs to nonregulated services." It ignores the anticompetitive effects of forcing one, and only one, player in

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[3] Notice, ¶ 24.
[4] Notice, ¶ 23.
[5] Notice, ¶ 23.

local telecommunications and video markets to compete wearing regulatory handcuffs. This incongruity is not surprising in view of the Notice's failure to grapple with powerful new competitive forces in local telecommunications markets. Instead, it approaches the issue with concepts that are rooted in outdated rate-of-return regulation. In accomplishing the 1996 Act's goal of promoting competitive market conditions,[6] the Notice should, but does not, ask whether forbearance from cost allocations would more effectively promote competition.

Finally, the Notice aims to balance "administrative simplicity; adaptability to evolving technologies; uniform application among incumbent local exchange carriers . . . and consistency with economic principles of cost causation"[7] - none of which pertains to the 1996 Act's goals of promoting infrastructure development and competitive entry.

This collage of objectives, purposes, intentions and considerations provides no coherent policy objectives for this proceeding. To achieve a result in this proceeding consistent with the goals of the 1996 Act, the Commission must clarify the public policy objectives of this proceeding and must rigorously test and justify every proposal by these clarified objectives. To do so, the Commission must address the following issues that the Notice ignores:

A. Should this proceeding promote investment in advanced telecommunications infrastructure?

B. Should this proceeding encourage incumbent LECs to be among the companies that invest in telecommunications infrastructure?

[6] Telecommunications Act of 1996, Pub. L. No. 104-104, 101 Stat. 56, Section 401, §10(a) (1996) ("1996 Act").
[7] Notice, ¶ 24.

C. Should this proceeding promote competitive market conditions and enhance competition among providers of telecommunications, information, and video programming services?

D. Should this proceeding encourage incumbent LECs to be among the companies that provide competitive new telecommunications, information, and video services?

Unless the Commission deals with these questions, it will not have fully considered the relevant issues in this proceeding. Furthermore, the Commission must not assume that its actions in this proceeding will not substantially affect incumbent LECs' incentives to risk capital in the deployment of advanced telecommunications infrastructure and in bringing competitive new services to market. If the Commission missteps here, the Information Age Network could be postponed indefinitely.

III. Price-Cap LECs Should Be Exempt From Cost Allocation Rules.

The Notice asks whether there are conditions under which the cost allocation rules are unnecessary.[8] Almost six years have passed since the price cap LECs were last subject to rate of return regulation. The cost allocation rules are a vestige of an antiquated rate of return regulation that should now be eliminated.

A. Price Cap Regulation Makes Cost Allocation Rules Unnecessary.

Cost allocations relate to the former regulatory regime, in which LECs' rates were based on accounting costs. Price cap regulation has broken the direct link between LECs' accounting costs and their rates.[9] It eliminates any incentive or ability to cross-

[8] Notice, ¶ 63.

[9] In BellSouth's case, this is true not only at the federal level, where BellSouth is subject to price caps and has also elected the no-sharing productivity factor, but also at

subsidize unprofitable lines of business with profitable lines of business. It provides regulated LECs the same economic incentives as unregulated businesses to provide only products and services that they expect to generate sufficient revenues to cover their costs, including direct costs and the cost of foregoing other uses of capital. Under price cap regulation (with or without sharing), LECs will invest in the provision of video programming or other nonregulated services only if doing so increases the value of the enterprise and not if doing so is expected to waste the firm's resources. With those incentives in place, there is no need for cost allocation rules. The Commission has recognized that price cap regulation is its primary means to protect against cross-subsidy.[10] The time has come for the Commission to take the next step and shed its allegiance to outdated mechanisms by exempting price-cap LECs from Part 64.

B. Continuation Of These Rules Is Inconsistent With The Commission's Regulation Of Cable Operators.

The Commission's adherence to cost allocation mechanisms for price cap LECs is inconsistent with its treatment of cable operators that have elected benchmark (price cap), instead of cost-of-service, rate regulation. The Commission's cost allocation and affiliate transaction rules for the cable industry apply only "to cable operators who either elect cost-of-service regulation or seek to adjust benchmark/price cap rates for affiliated programming costs."[11] Moreover the Commission did not apply its interim

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the state level, where all of BellSouth's states have adopted price cap regulation without sharing and all remnants of sharing will be eliminated by December 31, 1997.

[10] See, e.g., Memorandum Opinion And Order On Reconsideration, CC Docket No. 87-266, 10 FCC Rcd 244, ¶ 166 (1994) ("VDT Order").

[11] Report and Order and Further Notice of Proposed Rulemaking, MM Docket No 93-215 and CS Docket No. 94-28, FCC 94-39, 9 FCC Rcd 4527, ¶¶ 218, 227, 262 (1994) ("Cable Cost Order").

uniform system of accounts to cable operators that elected benchmark regulation, even though they might have later elected to convert to cost-of-service regulation.[12] The Commission explicitly recognized that such requirements are "unnecessary" because "the benchmark system is primarily concerned with an operator's prices, rather than costs."[13]

Only incumbent LECs are subject to the Commission's "rules governing the allocation of costs between regulated and nonregulated activities."[14] Thus, cable operators, who will enter the telephone business from a position of dominance in the cable business, will escape the onerous regulation that applies to incumbent LECs, as will electric utilities and others. By not imposing these onerous cost allocation procedures on others, the Commission implicitly acknowledges the lack of any benefit of cost collocation as a general matter. It is time for the Commission to correct the historical legacy that burdens LECs. Apart from the inefficiencies of cost allocation, failure to undo this outmoded regulatory approach will create a competitive imbalance. This imbalance will unfairly handicap telephone companies as they compete with cable operators in converging telecommunications and cable service markets.[15] Consumers

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[12] Second Report and Order, First Order on Reconsideration, and Further Notice of Proposed Rulemaking, MM Docket No. 93-215 and CS Docket No. 94-28, FCC 95-502, 11 FCC Rcd 2220, ¶ 29 (1996) ("Second Cost Order").

[13] Second Cost Order, n.265. See also Cable Cost Order, ¶ 218.

[14] Notice, n.10.

[15] BellSouth expects to face such competition before the end of 1996. In Atlanta, MediaOne, a subsidiary of US West, has been authorized to provide local service since October 1995 and is now upgrading its cable network. MediaOne has publicly announced its intention to offer telephone service to its cable subscribers later this year. MediaOne provides cable service to approximately 520,000 households in the Atlanta metropolitan area. In Tennessee, Time Warner, which provides cable service to more than 400,000 households, including more than 300,000 in the Memphis area, is

will be the losers, and incumbent cable operators the winners, when such imbalanced regulatory treatment diminishes LECs' incentives to deploy advanced broadband networks and to compete in the delivery of video programming services. The intentional perpetuation of such disparate treatment of competitors is contrary to Congress' intent "to promote competition [in video markets], to encourage investment in new technologies and to maximize consumer choice of services that best meet their information and entertainment needs."[16]

The Commission's approach to cost allocation and affiliate transactions should provide parity for the cable industry and LECs. The rules applicable to price-cap cable operators are more appropriate for both those cable operators and price-cap telephone companies than are the telephone rules. There is no need to saddle either industry with unnecessary regulation.

C. The 1996 Act Authorizes Elimination Of The LEC Cost Allocation Rules.

The 1996 Act removed the legal barriers to competitive provision of local exchange services.[17] With the elimination of barriers to entry in all telecommunications markets,

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authorized to provide local service and is upgrading its network. Time Warner has publicly announced that it should complete this upgrade by this Summer and has indicated that two of its markets in BellSouth's territory (Memphis and Orlando) are "ready to come on line" with residential telephone service. The Commercial Appeal, April 3, 1996, B4. In Florida, BellSouth has executed a local interconnection agreement with the Florida Cable Telecommunications Association, Teleport Communications Group, Time Warner/Digital Media Partners, Sprint, Intermedia Communications, Continental Cablevision, as well as MCImetro in Alabama and Florida and NEXTLINK in Tennessee.

[16] Telecommunications Act of 1996 Conference Report, H. Rep. 104-458 at 172 (January 31, 1996).

[17] 47 U.S.C. §253(a)

the Commission should adopt regulatory policies that promote infrastructure investment and should eliminate vestiges of rate of return regulation, particularly those, such as cost allocation rules, that artificially dampen incentives for such investment. The 1996 Act provides ample authority and direction to the Commission in this regard.

In Section 10 of the 1996 Act, Congress has expressly stated its intent that unnecessary regulation be removed by the Commission as soon as it is consistent with the public interest:

> (a) Regulatory Flexibility.--Notwithstanding Section 332(c)(1)(A) of this Act, the Commission shall forbear from applying any regulation or any provision of this Act to a telecommunications carrier or telecommunications service, or class of telecommunications carriers or telecommunications services, in any or some of its or their geographic markets, if the Commission determines that--
>
> (1) enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations by, for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory,
>
> (2) enforcement of such regulation or provision is not necessary for the protection of consumers; and
>
> (3) forbearance from applying such provision or regulation is consistent with the public interest.
>
> (b) Competitive Effect To Be Weighed.--In making the determination under subsection (a)(3), the Commission shall consider whether forbearance from enforcing the provision or regulation will promote competitive market conditions, including the extent to which such forbearance will enhance competition among providers of telecommunications services. **If the Commission determines that such forbearance will promote competition among providers of telecommunications services, that determination may be the basis for a Commission finding that forbearance is in the public interest.** [Emphasis added.]

Congress also included in the 1996 Act a provision expressly encouraging reductions in regulation to spur infrastructure investment. Section 706(a) provides:

> The Commission and each State commission with regulatory jurisdiction over telecommunications services **shall encourage the deployment on a reasonable and timely basis of advanced telecommunications capability** to all Americans (including, in particular, elementary and secondary schools and classrooms) by utilizing, in a manner consistent with the public interest, convenience, and necessity, **price cap regulation, regulatory forbearance, measures that promote competition in the local telecommunications market, or other regulating methods that remove barriers to infrastructure investment.** [Emphasis added.]

The plain language of this Section compels the Commission to move promptly to eliminate regulations that are inconsistent with infrastructure investment and the development of competition. The Commission can start by eliminating the Part 64 cost allocation rules. In any event, the Commission should facilitate, not hamper, the development of broadband capabilities in the public telecommunications network. Increasing cost allocations to emerging, competitive services is inconsistent with Congress' intent.

Section 254(k) of the 1996 Act does not require the continued application of cost allocation rules to price cap LECs. First, Section 254(k) is not limited to LECs. Thus, if Section 254(k) required cost allocation rules, the Commission would be required to apply those rules to cable operators, electric utilities, and any other person providing telecommunications services that also provide "services that are not competitive." Second, Section 254(k) requires "cost allocation rules" only if necessary. Even then, it does not codify the artificial distinction between regulated and nonregulated services on which the Notice rests. It does not even suggest that cost allocation should be the means to prevent cross-subsidy, but only that it might be used, if necessary, "to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services." Price cap regulation and open competitive entry are far more effective tools to accomplish that purpose than arbitrary cost allocation rules can ever be. The Commission cannot reasonably find cost allocation rules to be necessary for price cap LECs.

IV. Cost Reallocations, If Required, Should Not Receive Exogenous Treatment Under Price Cap Regulation.

The Commission seeks comment on whether Section 61.45(d)(1)(v)[18] of the Rules requires price cap LECs to treat as an exogenous cost change any reallocation of investment from regulated to nonregulated activities that may result from the proposals in the Notice.[19] As discussed below, Section 61.45(d)(1)(v) serves a very narrow purpose and should not be extended to the type of cost reallocations discussed in the Notice. Moreover, such cost reallocations are not beyond the control of the LEC[20] and do not otherwise meet the criteria for exogenous cost treatment under the Commission's price cap rules. Economies of scale and scope are principal sources of LEC productivity that are already reflected in the productivity offset in the LEC price cap adjustment formula. Expanding the scope of Section 61.45(d)(1)(v) to attempt to capture economies of scope resulting from the offering of new nonregulated services

[18] 47 C.F.R. §61.45(d)(1)(v) provides: "(1) Subject to further order of the Commission, those exogenous changes shall include cost change caused by: ... (v) The reallocation of investment from regulated to nonregulated activities pursuant to §64.901."

[19] Notice, ¶ 60.

[20] Notice, ¶ 60, n.68.

over the public telecommunications network would double count this source of productivity. Any attempt to capture additional scope economies through an exogenous cost adjustment would lead to a loss of consumer welfare and would be contrary to the public interest, because it would discourage the integrated provision of regulated and nonregulated services over the public telecommunications network.

A. Exogenous Treatment Would Not Serve The Purpose Of The Rule.

Section 61.45(d)(1)(v) was included in the price cap rules for a very limited purpose: to flow through to the price cap index any true-up in the forecast of nonregulated demand required by Section 64.901(b)(4) of the Rules. The true-up requirement was discussed in the AT&T Price Cap Order as follows:

> 302. Under rate of return regulation, these required reallocations translate into reductions in rate base and in regulated cost, which in turn produce reductions in regulated rates. Under our price cap proposal, however, reallocation of regulated investment to nonregulated activities would have no impact on interstate rates. The investment risk associated with plant **in place on the first day of price cap regulation** would continue to be borne by ratepayers and shareholders in accordance with the forecast in effect **on that day**, even if AT&T were later to dramatically increase its nonregulated use of that plant. . . . [Emphasis added.][21]

Exogenous treatment of reallocations of investment to nonregulated activities was carried forward into the LEC Price Cap Order.[22] As July 1, 1990, the date of the initial setting of LECs' price cap indices, becomes more distant, so does any logical connec-

[21] In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873, 3019 (1989) ("AT&T Price Cap Order").
[22] In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6807-8, ¶¶ 171-172 (1990) ("LEC Price Cap Order").

tion between the costs underlying those indices and LECs' current rates.

> 299. As time goes on, however, the rationale for continuing to allow exogenous cost changes to price cap rates is less compelling. As the pricing flexibility afforded by the price cap plan increasingly allows LECs to adjust rates to track economic costs, and to respond to competitive challenges, the **link** between **current prices** and **the initial price cap rates** should become more tenuous. This progress towards market-based rates, and away from rate-of-return regulation, will be impeded, however, if we continue indefinitely to allow exogenous cost adjustments that have **the purpose and effect of perpetuating the relationship between the accounting costs and rates that existed on July 1, 1990**. [Emphasis added.][23]

In the case of video programming services, the link between accounting costs and rates that existed on July 1, 1990, is tenuous indeed. Very little of BellSouth's infrastructure investment placed in service prior to July 1, 1990, is suitable or available to provide nonregulated video programming services. In BellSouth's case, the infrastructure necessary to provide video programming services includes fiber optic cables, as well as SONET transport electronics (*e.g.*, multiplexers and transmitters/receivers, etc.) and broadband (ATM) switches, which are necessary to concentrate, transmit, receive, and route video signals over fiber cables. Additionally, poles and conduit are needed.

Transport Electronics and Switching. In 1990, no ATM or SONET facilities were in service in BellSouth. Additionally, because of rapid technological advances, electronic equipment has a relatively short life expectancy. Of the $5.38 billion of investment in transport electronics in service in BellSouth on January 1, 1990, for example, 33 percent ($1.77 billion) was retired from service by January 1, 1996.

[23] In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, First Report and Order, 10 FCC Rcd 8961, ¶ 299(1994) ("LEC Price Cap Performance Review Order").

The bulk of the cost to provide video programming services lies in the cost of transport electronics and switching facilities Virtually none of BellSouth's pre-July 1990 investment in such facilities is suitable for these services

Fiber Optic Cables. Very little if any of BellSouth's fiber facilities in service on July 1, 1990, are available for use in providing video programming services. The bulk of the fiber facilities in service on July 1 1990 were interoffice facilities (*i.e.*, cables which link central offices together and which do not extend in the transport loop toward the customer). At the beginning of 1990 less than 5 percent of BellSouth's feeder loop circuits (*i.e.*, cables extending from the central office to a remote terminal) utilized any fiber and no fiber distribution loop facilities (*i.e.* cables extending from the remote terminal to the terminal block near the customer home) utilized fiber, except fiber-to-the-home trials. The fiber cables in service were by design typically sized with enough spare capacity to accommodate only 10 years worth of normal telephony growth with no additional spare capacity. Since then, this growth capacity has been consumed much faster than expected Roughly 14 percent of the fiber facilities have been retired and are no longer available for use Much higher than expected growth has exhausted most of the spare growth capacity Very little of the initial spare capacity is still available That which is available is needed for future telephony growth.

Poles and Conduit. Some poles and conduit in service on July 1, 1990, can probably be used for the provision of video programming services. The total investment in poles and conduit is small relative to total infrastructure investment.

The portion of this investment that would be allocated to nonregulated video services would also be small.

B. Exogenous Treatment Would Double Count Productivity Gains.

While Section 61.45(d)(1)(v) requires a true-up for any underforecast of relative regulated and nonregulated usage of the network, the true-up is not the mechanism in the LEC price cap plan for capturing economies of scale and scope.[24] Economies of scale and scope are the principal factors that permit LECs to be more productive than the economy as a whole. The Commission has recognized this fact by imposing a productivity offset in the LEC price cap adjustment formula. Ratepayers receive the benefit of economies of scale and scope through the productivity offset in the price cap plan.[25] Creating a separate exogenous cost adjustment to capture the benefits of scope economies for ratepayers would effectively double count these economies in the price cap adjustment formula. Thus, the discussion in paragraph 23 of the Notice is misplaced. The Commission does not need to "to allocate a significant portion of common costs to nonregulated services" to capture the benefit of scope economies for ratepayers. Since scope economies are already reflected in the productivity offset, they do not meet the test for an exogenous cost adjustment.

[24] Notice, ¶ 23.
[25] See, e.g., AT&T Price Cap Order, 4 FCC Rcd 2873, 3222, ¶ 723 (1989).

C. Exogenous Treatment Would Discourage LEC Investment In Advanced Telecommunications Capabilities.

The Commission must consider the impact of revisions in its cost allocation and price cap rules on the incentives of carriers to develop new services for delivery over the public telecommunications network. Congress has directed the Commission and state commissions to "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans . . . ."[26] Moreover, the Commission has expressed commitment to providing proper incentives for the deployment of new technology in the network through its price cap rules.[27] As the Commission stated in the LEC Price Cap Performance Review Order:

> Recognizing the dynamic nature of technological change in telecommunications, we also seek to encourage the deployment of new, innovative services. The current price cap plan seeks to achieve these goals by replicating many of the incentives of a competitive market, and thus encourage price cap LECs to make economic decisions similar to those they would make in a fully competitive market.[28]

If the Commission revises its rules to allocate more costs to nonregulated activities that utilize the public telecommunications network and requires an exogenous cost adjustment to reduce the prices charged for other services, it will provide a major disincentive for LECs to deploy advanced telecommunications capabilities. Such adverse treatment of LECs' attempts to participate fully in the

[26] 1996 Act §706(a).

[27] This is fully consistent with the express will of Congress now, as well as prior to the 1996 Act: "It shall be the policy of the United States to encourage the provision of new technologies and services to the public. . . ." 47 U.S.C. §157(a).

[28] LEC Price Cap Performance Review Order ¶ 65.

future of telecommunications may create an insurmountable barrier to their deployment of advanced telecommunications capabilities in the public telecommunications network

In competitive markets, the introduction of a new service utilizing joint and common resources does not cause an adjustment to the price of the existing services utilizing those resources. The prices of both the new service and the existing services are driven by market forces, not artificial cost allocations. An exogenous cost adjustment to the price of existing network services is inconsistent with the result that would obtain in a fully competitive market. If the Commission sincerely desires to reduce unnecessary regulation, it will emulate the results that would obtain in a fully competitive marketplace and eliminate Section 61.45(d)(1)(v) of the Rules.

A downward adjustment in the LEC price cap index every time a new nonregulated service is offered over the public telecommunications network would be irrational. Such a requirement would force the new service to bear not only its direct cost and a market-determined share of joint and common costs, but also an artificial opportunity cost in the form of a reduction in existing revenues. Since the prices that can be charged are set by competitive market conditions, an additional opportunity cost burden would be a powerful disincentive to the provision of new services over the public telecommunications network. An exogenous cost adjustment would force LECs either to construct separate networks for the provision of new services, thereby foregoing scope economies, or not to offer the new services at all. Either result would diminish the public welfare.

The Notice acknowledges that to be considered exogenous costs must be "incurred by means that are beyond the control of the carrier and that they are not otherwise accounted for in the price cap formula."[29] If reallocations and resulting price cap adjustments create significant economic penalties LECs can choose to avoid actions that would produce such penalties. The decision to introduce new services on an integrated basis over the public telecommunications network is within the control of the carrier, and thus any resulting reallocations of investment would fail this prong of the test for exogenous cost treatment as well.

V. If The Commission Retains Cost Allocation Rules, It Should Make Them Less, Not More, Arbitrary.

It would be a serious mistake for the Commission to perpetuate its outmoded, cost allocation approach to LEC regulation. Nevertheless, if the Commission goes forward with the retrogressive approach tentatively adopted in the Notice, BellSouth urges the Commission not to make its cost allocation rules any more arbitrary and adverse to competition and the public welfare.

The Notice states that the Commission's "current cost allocation rules were not designed for" the task of allocating "common costs between the nonregulated offerings that will be introduced by incumbent local exchange carriers and the regulated services they already offer."[30] The Notice is incorrect. Part 64 was expressly designed to regulate the allocation of common costs between regulated and nonregulated activities. Part 64 explicitly recognizes that such allocation may include investment in central

[29] Notice, n.68.
[30] Notice, ¶ 2.

office equipment and outside plant. It provides that central office and outside plant investment jointly used for regulated and nonregulated activities shall be allocated "based upon the relative regulated and nonregulated usage of the investment during the calendar year when nonregulated usage is greatest in comparison to regulated usage during the three calendar years beginning with the calendar year during which the investment usage forecast is filed."[31]

Part 64 does not prescribe the metric by which usage for each type of plant is to be measured, but establishes the general principle for allocation of such investment. The Commission should not deviate from this approach but should continue to leave such details to the Cost Allocation Manual ("CAM") of each LEC. The Commission should not compound the inherent arbitrariness of its requirements for allocating joint costs with the arbitrary prescription of singular allocation methods, formulas, factors, or percentages. Such rigidity could have unpredictable and greatly disparate effects on individual companies. LECs, their networks, their business plans, and their markets are more heterogeneous than ever. Therefore, a cookie-cutter approach to arbitrary cost allocations cannot possibly affect all companies the same.

A. The Commission Should Not Prescribe Specific Allocation Methods or Factors.

On June 30, 1995, BellSouth filed CAM revisions to describe how it would assign the costs of providing cable service[32] between regulated and nonregulated service categories. These revisions were unopposed and went into effect September

[31] 47 C.F.R. §64.901(b)(4).

[32] BellSouth's procedures apply to the provision of cable service over a cable system or an open video system.